

Internal Revenue Service
memorandum

CC:TL-N-6964-91

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date:

Jul 19 1991
to: District Counsel, Las Vegas CC:LV
Attn: Rollin Thorley

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [REDACTED]
Progressive Slot Liability

This is in response to your request for litigation advice dated May 8, 1991, concerning the above-mentioned case.

ISSUE

Whether the economic performance requirement of I.R.C. § 461(h) applies to taxpayer's progressive slot liability prior to the effective date of regulations to be promulgated under the authority of that section.

CONCLUSION

Due to litigation hazards, we do not recommend applying the section 461(h) economic performance requirement to jackpot liabilities prior to the 1991 regulation effective date.

FACTS

[REDACTED], an accrual basis taxpayer, operates a number of progressive jackpot slot machines. At year end, the progressive jackpot amounts are totalled, and any increase over the total at the beginning of the year is accrued as a deductible expense. This tax treatment is in accordance with the Supreme Court's decision in United States v. Hughes Properties, Inc., 476 U.S. 593 (1986), in which the Court held that the all events test of section 461 was satisfied at year end. The obligation to pay the jackpots was fixed and irrevocable under Nevada law, and the remote and speculative possibilities that a jackpot might not be won had no effect on the proper time to accrue a deduction for the fixed jackpot liabilities. The economic performance requirement of section 461(h) was enacted in 1984 and was not applicable to the years at issue in Hughes.

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The years at issue herein are [REDACTED], and taxpayer has continued to follow Hughes notwithstanding the economic performance requirement of the section 461 all events test, which was effective in 1984.

You have indicated that revenue agents in your district have disallowed these deductions in numerous cases, relying on section 461(h)(2)(B), which states that if the liability of the taxpayer requires the taxpayer to provide property or services, economic performance occurs as the taxpayer provides such property or services. In addition, you believe that taxpayers who previously applied an economic performance requirement to their progressive slot liabilities will now be filing protective refund claims pending the outcome of the [REDACTED] litigation.

DISCUSSION

The economic performance requirement added to the Code in 1984, provides that, in determining whether an amount has been incurred with respect to any item during the taxable year by a taxpayer using the accrual method of accounting, all the events which establish liability for such amount generally are not to be treated as having occurred any earlier than the time economic performance occurs. The section 461(h) principles describe the two most common categories of liabilities: cases where the liability arises as a result of another person providing goods and services to the taxpayer, and cases where the liability requires the taxpayer to provide goods and services to another person. If the liability arises out of the use of property, economic performance occurs as the taxpayer uses the property. If the liability requires a payment for the providing of property or services, economic performance occurs when the property or services are provided. § 461(h)(2)(A). If the liability of the taxpayer requires the taxpayer to provide property or perform services, economic performance occurs as the taxpayer provides the property or performs the services. § 461(h)(2)(B).

The Joint Committee on Taxation stated in the Blue Book that property does not include money; that is, economic performance generally does not occur as payments are made except as specifically provided in the Code or regulations. The Code does provide a special rule for workers' compensation and tort liabilities which require payments to another person; economic performance occurs as payments are made to that person. section 461(h)(2)(C). In the case of any other liability of the taxpayer, economic performance will occur at the time determined under regulations to be prescribed by the Secretary.

section 461(h)(2)(D). See General Explanation of the Revenue Provisions of the Tax Reform Act of 1984, 98th Cong., 2d Sess. 261 (Staff of the Joint Comm. on Taxation, 1984).

Prop. Treas. Reg. § 1.461-4(g)(4), Awards, prizes, and jackpots, states that "[i]f the liability of a taxpayer is to provide an award, prize, jackpot, or other similar payment to another person, economic performance occurs as payment is made to the person to which the liability is owed." This regulation was issued pursuant to section 461(h)(2)(D) which provides that in the case of other liabilities of the taxpayer, "economic performance occurs at the time determined under regulations prescribed by the Secretary."

When published on June 7, 1990, the proposed regulations provided that the effective date for liabilities requiring payment in order for economic performance to occur was the taxable year beginning after December 31, 1989. On March 18, 1991, Notice 91-10, I.R.B. 1991-11, was published. That Notice delayed the effective date for both the payment rule, which applies to the seven groups of liabilities defined in the proposed regulations implementing section 461(h)(2)(D), and for the recurring item exception, until the taxable year beginning after December 31, 1990. Therefore, the economic performance rule of payment for jackpot liabilities is not effective until after December 31, 1990. As noted above, property does not include money; thus, progressive slot machine liabilities do not come within the provisions of section 461(h)(2)(B). Accordingly, we believe that there is no reasonable basis for the Service to apply a payment rule retroactively, and no other definition of economic performance for progressive slot machines applies. In the absence of regulations in the gap years between 1984 and the 1991 regulation effective date, we believe that taxpayers can rely on the law as set out in Hughes.

In summary, until the effective date of section 461(h) regulations, we believe that taxpayers may rely on prior law on jackpot liabilities, i.e., a Supreme Court case directly on point. The payment rule of Prop. Treas. Reg. § 1.461-4(g) is effective for taxable years after December 31, 1990, Notice 91-10, I.R.B. 1991-11 (March 18, 1991). The payment rule may not be applied prior to the effective date of the regulations.

The Service has definitively approved a similar analysis for one type of liability which also requires payment for economic performance. For taxes, economic performance occurs as the tax is paid to the governmental authority. Prop. Treas. Reg. § 1.461-4(g)(6). The issue of property tax accruals for utility companies was extensively considered in the national office. We concluded that there were insurmountable litigation hazards for various reasons, not the least of which was the


prospective payment rule which may be viewed as a relief provision for taxpayers. In Notice 90-64, I.R.B. 1990-44 (October 29, 1990), the Service stated that the proposed regulations do not define when economic performance occurs for taxes between the 1984 effective date of section 461(h) and the 1991 effective date of the regulations. The Service determined that prior to the effective date of the regulations it would not challenge positions taken by taxpayers which relied on earlier published rulings relating to the accrual of property taxes.

We believe that given the prospective effective date of the economic performance regulations for jackpot liabilities, taxpayers may reasonably rely on the law of Hughes Properties, and our litigation hazards are insurmountable for arguing for the implementation of any type of economic performance definition to defer the accrual of jackpot liabilities beyond the year end accrual approved by the Supreme Court in Hughes.

If you have any further questions concerning this matter, please contact Joyce C. Albro at FTS 566-3442.

MARLENE GROSS

By:


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